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Analysis: On balance sheet lease accounting looms large

by Stephen Bouvier 04 Oct 2013

THE EARLY MESSAGES from responses to the IASB and FASB's joint lease accounting proposals are clear.

For preparers, bringing lease assets and liabilities onto their balance sheets is do-able, while users of financial statements, despite some reservations, can settle for what's on offer.

The two boards launched the leases project back in 2006 when convergence was still a buzzword. They released a discussion paper in March 2009, followed by an exposure draft in August 2010, before issuing a second in May 2013. The boards are now poised to start their joint re-deliberation of the 2013 document later this year or early next.

The 2013 exposure draft proposes that lessees should recognise a right-of-use asset and corresponding liability for all leases with a term exceeding 12 months. But in response to protests from some constituents that leases of different types of underlying asset result in different economics, the document treats leases of equipment - known as type A leases - differently from leases of real estate - known as type B leases - in the income and cashflow statements.

The greatest impact will be among operating lessees. The exposure draft allows preparers to simply straight-line any lease for a term of less than 12 months.
On the lessor side, the accounting is essentially unchanged for property. However, under the proposals, vehicle lessors will recognise a lease receivable and derecognise the underlying asset. A lessor would also recognise interest income on both the lease receivable and the residual asset over the term of the lease.

General support

In a bid to assess the impact of the proposed new model, the IASB launched an intensive outreach programme among both users of financial statements and preparers. The outcome of this work looks set to define the focus of the board's re-deliberations.

Among the users consulted, staff noted in a recently published feedback statement, that credit analysts "generally support the changes proposed to a lessee's balance sheet." This support appears to hinge on their need for "better information about leverage."

So too do analysts drawn from the credit rating agencies who also "generally support recognising lease assets and lease liabilities on the balance sheet", staff report. Again, these users believe leases create debt-like liabilities for lessees.

Reconciling the views of equity analysts, however, will prove challenging. For example, although many equity analysts agree that operating leases create assets and liabilities, it is equally true that some are troubled by "any change to financial reporting".

Commenting on the feedback, Andrew Watchman, global IFRS leader for Grant Thornton International, says: "Given that this project is for the benefit of users, the boards must be pleased that they've done this outreach. They are right to take it seriously."

He noted, however, the less than enthusiastic response from the FASB's investor advisory panel.

"The staff at both boards will have to steer a middle path. They will doubtless be encouraged by the results of the outreach, but I don't read it as a universal thumbs up from users," he says. Preparers, he adds, will find the proposals challenging to apply.

Disclosure fudge

On 13 September, the ACCA's Global Forum for Corporate Reporting called on IASB to withdraw its lease proposals. As for what might fill the void, preparer groups ACTEO/AFEP/MEDEF have suggested enhanced disclosures as an interim solution.

This, Watchman believes, is a fudge: "Any disclosure would have to be aggregated - perhaps very significantly so - and this makes me question whether a user would get all the information they need for their calculations.

"Of necessity, a disclosure-based workaround would give them ranges and averages, and I think there is always the risk with that level of aggregation that it would tend to be rather boilerplate."

In short, disclosures offer no quick fix. "To a large extent the disclosures should explain the financial statements, not serve as a substitute for them. If the right amounts are not in the financial statements, the footnotes have to work a lot harder to fill in the gaps that are left."

If you had to call this project now, the days of off balance sheet accounting for leases are numbered.

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